Internal Revenue Service

memorandum

CC:TL:TS
ESHATZ

date: AUG 23 1990

to: District Counsel, Denver
ATTN: David P. Monson

from: Acting Branch Chief, Tax Shelter Branch CC:TL:TS

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subject: [redacted]
TL-N-7123-90
Shatz Wilson Denver
I.R.C. § 6231(a)(7).

This memorandum responds to your request for technical advice in the above-captioned cases regarding the validity of consents to extend the partnership limitations periods when the TMP filed a petition in bankruptcy and was subsequently dismissed.

ISSUES

1. Does [redacted]'s filing for bankruptcy on [redacted], terminate his status as tax matters partner of the partnerships?

2. Does the doctrine of equitable estoppel preclude the partnerships from arguing that the statute of limitations for the [redacted] taxable year has expired when the consent to extend the statute of limitations was executed by [redacted] three days after he filed for bankruptcy and the Service did not have notice of the bankruptcy?

3. Did [redacted]'s dismissal from bankruptcy result in him being authorized to consent to extend the statute of limitations for the taxable year [redacted]?

CONCLUSION

ISSUE 1.

The filing of a bankruptcy petition by [redacted] disqualifies him from serving as tax matters partner because a claim for income taxes could be filed by the United States in the

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bankruptcy proceeding and his partnership items convert to nonpartnership items. Temp. Reg. §§ 301.6231(a)(7)-1T(1)(4) and 301.6231(c)-7T(a).

ISSUE 2

Based on the doctrine of equitable estoppel, the partnerships should be precluded from challenging the validity of the statute extensions executed by [redacted] as tax matters partner. At the time the extensions were executed, the Service was unaware of [redacted]'s bankruptcy petition and his resulting ineligibility to serve as tax matters partner of the partnerships. The Service reasonably relied on [redacted]'s ability to extend the statute of limitations on behalf of the partnerships, and therefore we recommend defending the validity of the extensions.

ISSUE 3

Section 349 of the Bankruptcy Code provides that the effect of the dismissal of a bankruptcy petition is to restore the debtor to the position he was in prior to the filing of the bankruptcy petition. Therefore, [redacted], as the sole general partner of the partnerships, may be considered to have authorized himself to extend the statute of limitations for the [redacted] taxable year of partnerships after the bankruptcy petition is dismissed.

FACTS

[redacted] and [redacted] are TEFRA partnerships. Both partnerships are currently under audit by the Denver District for the tax years [redacted], [redacted] and [redacted]. According to the Schedules K-1 appended to the partnership returns [redacted] is the sole general partner of [redacted] and [redacted].

Extensions of the statute of limitations for [redacted] and [redacted] for the [redacted] tax year had been executed by [redacted] prior to his filing a bankruptcy petition and are not at issue here.

On [redacted], [redacted] filed a petition pursuant to the provisions of Chapter 11 of the Bankruptcy Code. On [redacted], [redacted] signed Forms 872-O, extensions of the statute of limitations of the partnership tax year [redacted] for both [redacted] and [redacted]. The extensions were signed by [redacted] in his ostensible capacity as tax matters partner for both partnerships. The extension for [redacted] was countersigned by the Service on [redacted], and the extension for [redacted] was countersigned on [redacted]

[redacted]. At the time the statute extensions were signed and countersigned the Service was not aware that [redacted] had filed a petition in bankruptcy.

On [redacted], [redacted] filed a motion to dismiss the bankruptcy case, and on [redacted], the motion was granted pursuant to 11 U.S.C. § 369.

On [redacted], [redacted] signed a Form 872-P, for both [redacted] and [redacted], extending the statute of limitations for the [redacted] tax years of both partnerships to [redacted]. On [redacted], [redacted] signed a Form 872-P for both [redacted] and [redacted], extending the statute of limitations for the [redacted] tax year until [redacted] Both of the statute extensions were signed in his capacity as tax matters partner of both partnerships.

DISCUSSION

ISSUE 1

The validity of the consents extending the statute of limitations for the [redacted] tax year of the partnerships depends upon whether [redacted] was the proper party to act on behalf of the partnerships. If [redacted] is not the proper party to have signed on behalf of the partnerships then it is necessary to determine whether the partnerships are estopped from challenging the validity of the consents.

Pursuant to I.R.C. § 6229(b)(1)(B), the period for assessing any tax which is attributable to any partnership item or affected item for a taxable year may be extended with respect to all partners, by an agreement entered into by the Secretary and the tax matters partner, (or any other person authorized by the partnership in writing to enter into such an agreement). Under I.R.C.§ 6231(a)(7), the tax matters partner of the partnership is the general partner designated by the partnership as the tax matters partner as provided in the regulations. In the absence of a designation of TMP by the partnership, the TMP is the general partner having the largest profits interest in the partnership a the close of the taxable year. I.R.C. § 6231(a)(7)(B). If it is impractical to apply the largest profits interest rule of section 6231(a)(7)(B), the Secretary may select a partner as TMP. I.R.C. § 6231(a)(7), Rev. Proc. 88-16, 1988-1 C.B. 691.

Section 6231(c) of the Code permits the Secretary to determine special enforcement areas in which it is more appropriate to treat items as nonpartnership items if treatment as partnership items would interfere with the effective and

efficient enforcement of the Internal Revenue laws. Temp. Treas. Reg. § 301. 6231(c)-7T(a) states:

> The treatment of items as partnership items with respect to a partner named as a debtor in a bankruptcy proceeding will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership items of such a partner arising in any partnership taxable year ending on or before the last day of the latest taxable year of the partner with respect to which the United States could file a claim for income tax due in the bankruptcy proceeding shall be treated as nonpartnership items as of the date the petition in bankruptcy is filed.

Given the responsibilities placed on the tax matters partner in a TEFRA proceeding, the filing of a bankruptcy petition by a tax matters partner may impair the tax matters partner's ability to fully comply with the requirements of the Code and the Tax Court rules. Therefore, Temp. Treas. Reg.§ 301.6231(a)(7)-1T(1)(4) provides that a partner's status as tax matters partner terminates upon the conversion of the partner's partnership items to nonpartnership items under § 6231 (c). Crucial to determining the date on which the tax matters partner becomes ineligible is the date on which the partner's items convert.

Under Temp. Treas. Reg. § 301.6231(c)-7T(a), the conversion occurs "as of the date the petition naming the partner as debtor is filed in bankruptcy" if the U.S. could file a claim in the bankruptcy for income taxes.

In this instance, at the time the bankruptcy petition was filed, on [redacted], the United States could file a claim against [redacted] for [redacted] and [redacted]. Therefore, the partnership items of [redacted] for those years converted as of [redacted], and, pursuant to Temp. Treas. Reg. § 301.6231(a)(7)-1T(1)(4), [redacted]'s status as the tax matters partner of the partnerships terminated. Because [redacted] was not the tax matters partner at the time he executed, the consents on behalf of the partnerships on [redacted], those consents were not valid.

ISSUE 2

Although by virtue of his bankruptcy [redacted] was not tax matters partner and therefore not authorized to sign consents on behalf of the partnerships, the doctrine of equitable estoppel may preclude the partnerships from denying their validity. A taxpayer may be estopped to deny the validity of a consent to extend the period of limitations where the Service reasonably relies upon the extension executed by the taxpayer. Piarulle v. Commissioner, 80 T.C. 1035,1044 (1983); See also Benoit v.

Commissioner, 25 T.C. 656 (1955), aff'd 238 F2d, 485 (1st Cir. 1956). The doctrine of equitable estoppel requires that four elements be established:

> 1. There must be a false representation or a wrongful misleading silence;
>
> 2. The error must originate in a statement of fact, not in an opinion or a statement of law;
>
> 3. The one claiming the benefits of estoppel must not know the true facts;
>
> 4. That same person must be adversely affected by the acts or statements of the one against whom an estoppel is claimed.

Lignos v. United States, 439 F.2d 1365,1368 (2nd Cir. 1971); Century Data Systems Inc. v. Commissioner, 86 T.C. 157, 165 (1986).

Applying these requirements to the facts presented, the elements of estoppel appear to be satisfied. First, [redacted] failed to notify the Service of the filing of his bankruptcy petition, an act which pursuant to Temp. Treas. Reg. § 301.6231(c)-7T and Temp. Treas. Reg. § 301.6231(a)(7)-1T(1)(4) disqualified him from serving as the tax matters partner of the partnerships. This omission is the equivalent of a wrongful misleading silence. Second, [redacted]'s status, as a debtor in bankruptcy, was of a factual nature, rather than an opinion or a statement of law.

Third, the Service, as the party seeking to invoke the doctrine of estoppel, was not aware of [redacted]s bankruptcy petition and therefore was unaware of his disqualification at the time the statute extensions were executed. Although the Tax Court rejected the possibility of an estoppel argument in Barbados #7 v. Commissioner, 92 T.C. 804, 813 (1989), the facts of this case are distinguishable. In Barbados #7, the tax matters partner of the partnerships in question filed a petition under Chapter 11 of the Bankruptcy Code on August 1, 1983. The Service received notice of the bankruptcy. On January 5, 1987, Bajan executed an agreement to extend the statute of limitations for the partnerships. In rejecting the Service's argument that the partnerships were estopped from arguing that the statute of limitations had expired, the Tax Court stated:

> Even if we were to consider the estoppel argument, we would conclude that the doctrine does not apply to these facts. Respondent was notified of Bajan's bankruptcy and was, therefore, on notice of its lack of

authority to execute a waiver of the statute of limitations. Respondent's reliance on the waiver executed by Bajan was thus not reasonable.

Id. 92 T.C. 804 at 813.

The Tax Court goes on to note in footnote seven that "The situation might otherwise be different had respondent not been aware of Bajan's bankruptcy. See e.g. Benoit v. Commissioner, 25 T.C. 656 (1956), vacated and remanded on other grounds 238 F.2d 485 (1st Cir. 1956)."

In this instance the Service was presumably not aware of [redacted]'s bankruptcy at the time the consents extending the statute of limitations were signed on [redacted]. Nor, presumably, was the Service aware of [redacted]'s status when the consents were countersigned shortly thereafter by the Service. Thus, this situation is analogous to the facts described by the Tax Court in footnote seven and can be distinguished from the facts presented in Barbados #7.

The final element of the doctrine of equitable estoppel requires that the party seeking to invoke the doctrine be adversely affected by the acts or statements of the one against whom an estoppel is claimed. In other words, the Service must demonstrate that it relied to its detriment on the representation of [redacted] that he was the tax matters partner of the partnerships and qualified to sign the consents. In this instance without the consents to extend the statute for the [redacted] tax years the period to assess the tax for any partnership or affected item expired. Therefore, the effect of the Service's reliance on [redacted]'s status as tax matters partner, in the absence of the doctrine of equitable estoppel, is to bar the Service from making any adjustments for the [redacted] tax years of the partnerships.

ISSUE 3

The third issue is the validity of the consent signed by [redacted] after the dismissal of his bankruptcy pursuant to 11 U.S.C. § 349.

You have suggested that the dismissal from bankruptcy resulted in the automatic selection of [redacted] as TMP under Temp. Reg. § 301.6231(a)(7)-1T(m). This is a modified version of the "reselection" theory unsuccessfully argued in Barbados #7, supra. Implicit in this argument is the assumption that 11 U.S.C. § 349 reversed the termination of [redacted]'s status as TMP which had been triggered by the filing of his petition in bankruptcy under

Temp. Reg. § 301.6231(a)(7)-1T(1)(4).1/ Such an assumption is not entirely without merit, but raises considerable problems in other areas and we do not recommend that this argument be made here.

Instead we recommend that the consent for [redacted] be argued as valid because, under § 6229(b), [redacted] was authorized to execute a consent, regardless of his status as TMP.

[redacted] was the sole general partner. Section 6229(b)(2) states that the only persons who can validly consent to extend the statutes of limitations period for a partnership are the TMP or someone "authorized by the partnership in writing." Under Temp. Reg. § 301.6229(b)-1T, the written authorization must be signed by the general partners. We believe that in situations such as the instant one, where there is only one general partner and he is the one who has signed the consent, no separate written authorization is required. This is because such a separate authorization would only be a statement written by him authorizing himself; such an authorization is implicit in his signature on the consent itself. See Barbados #7, supra, footnote 3.

This argument was made in Barbados #7 and rejected because of state law. Id. 92 T.C. 804 at 812. There is a similar state law here. Colo. Rev. Stat. 7-62-402(i)(d)(II)(1986) provides that the filing of a bankruptcy petition results in the automatic withdrawal of that partner from the partnership. Colo. Rev. Stat. 7-62-801(1)(c) provides that when there is only one general partner, as here, such a withdrawal results in the dissolution of the partnership. In Barbados #7, supra, the Tax Court held that a similar state law deprived the sole general partner of any authority to act on behalf of the partnership. The difference between Barbados #7 and this case is the dismissal of the bankruptcy and the effect of 11 U.S.C. § 349.

Regardless of whether 11 U.S.C. § 349 reverses the determination of a TMP's status, it does clearly restore property rights, 11 U.S.C. § 349(b). Partnership interests are property rights and therefore we believe that § 349(b) mitigates the effects of Colorado state law. Therefore, upon the dismissal of [redacted]'s bankruptcy, his action as the sole general partner in consenting to extend the period of limitations was valid.

1/ Closely related, but not at issue in this argument is the question whether the dismissal under 11 U.S.C. § 349 reverses the conversion of partnership items under Temp. Reg. § 301.6231(c)-7T.

We understand that you have further factual information regarding the partnership agreement which may have an impact on this analysis. If so please submit that agreement to this office for review and we will be happy to provide a supplemental opinion to this memorandum.

Should you have any questions regarding this matter, please contact Eileen Shatz at FTS 566-3233.

CURTIS G. WILSON